Danger zone

The top-performing hedge fund manager that's too hot for big money to handle

By Lawrence Delevingne | **Filed** April 13, 2016, 4 p.m. GMT

Guided by Mark Nordlicht, Platinum Partners has racked up returns that are the envy of the industry. But its winning strategy – lending to troubled companies – carries risks that many institutional investors would just as soon not take.

NEW YORK – Investing in Glacial Energy Holdings Inc should have been a disaster.

Starting around 2010, hedge fund manager Platinum Partners lent the reseller of electricity and natural gas tens of millions of dollars, and then took at least a 20 percent equity stake in the fast-growing company.

Then, trouble started. By 2013, Texas utility regulators had fined Glacial $100,000 for overbilling customers and not disclosing that founder and Chief Executive Officer Gary Mole's previous energy venture had collapsed. Mole was forced to resign from the company's Texas subsidiary.

GOLDEN TOUCH: Mark Nordlicht continually flirts with disaster to deliver extraordinary returns to investors in Platinum Partners' two main funds. REUTERS/Mark Hartman

Mole and his company were also targeted by former employees and a onetime partner in at least 10 lawsuits from 2009 to 2014, alleging, among other things, embezzlement, a hostile work environment, underpayment, and racketeering. Glacial beat back most of the legal challenges, but as debt mounted, the energy retailer filed for bankruptcy in 2014, listing more than $1 billion in unpaid obligations.

Platinum's ownership stake in the company wasn't worth much, according to a person familiar with Platinum's history. But the firm had earned as much as $20 million in interest on its Glacial loans, which carried annual rates as high as 22 percent.

Then, Platinum delivered the master stroke, snapping up Glacial's assets out of bankruptcy for about $53 million. Since then, Agera Energy LLC, the Platinum-backed company that inherited Glacial's customers, has quintupled in value, according to the person familiar with the hedge fund firm.

Turning painful situations into profit is the peculiar genius of Platinum founder Mark Nordlicht. The linchpin of his success: the increasingly popular strategy known as asset-based lending. The idea is to provide high-interest loans to companies other lenders shun and, if the company runs out of cash, take ownership and ultimately flip it for a profit.

With that approach, combined with more traditional investment strategies, Nordlicht has generated spectacular results. Platinum's approximately $720 million Value Arbitrage fund has generated average annual returns of about 17 percent since 2003, according to Platinum performance data reviewed by Reuters. The flagship fund's investments are about evenly divided between private debt and shorter-term investments in stocks and other securities. The roughly $540 million Credit Opportunities fund, which focuses on debt, has averaged annual gains of 13.4 percent since 2005, making money every month but one. Neither has ever posted a decline for a calendar year.

Last year, hedge funds overall dropped an average of about 1 percent. Platinum's Value Arbitrage fund, meanwhile, gained 9.4 percent, far ahead of its sector average of 2.46 percent. The Credit Opportunities fund gained 9.8 percent, trouncing a benchmark credit-fund gain of 0.07 percent.

And yet Platinum, with about $1.35 billion under management, remains relatively

small next to other high-performance hedge fund firms.

Platinum has attracted enough pension funds, endowments and other institutional investors to bring their share of the firm's assets to about 35 percent, according to the person with knowledge of the firm, who declined to identify any of those investors. But they remain too few and their investments too small to vault Platinum into the big league.

An important reason is what industry insiders call "headline risk." Nordlicht's investments and his approach to them, these hedge fund investors say, come with too many potential public-relations challenges. On top of that, some investors worry that many of Platinum's investments are too complex to exit quickly to cover heavy redemptions.

A Reuters review of Platinum's investments, interviews with hedge fund investors familiar with the firm, as well as former employees, clients and associates, and a review of marketing and other documents show that Platinum has a history of investing in controversial businesses.

In their pursuit of outsize returns, Platinum and Nordlicht have put money into a consumer finance company repeatedly fined for predatory lending before and after Platinum's involvement, a pair of investments that turned out to be Ponzi schemes, and two energy companies that later went bankrupt and are facing criminal charges.

"Investors looking beyond the impressive headline returns will find a pattern of behavior that raises serious questions about ethics, morals, and a host of other risks an investor must take to achieve those returns," said Ted Seides, the recently departed co-founder of hedge fund investment firm Protégé Partners.

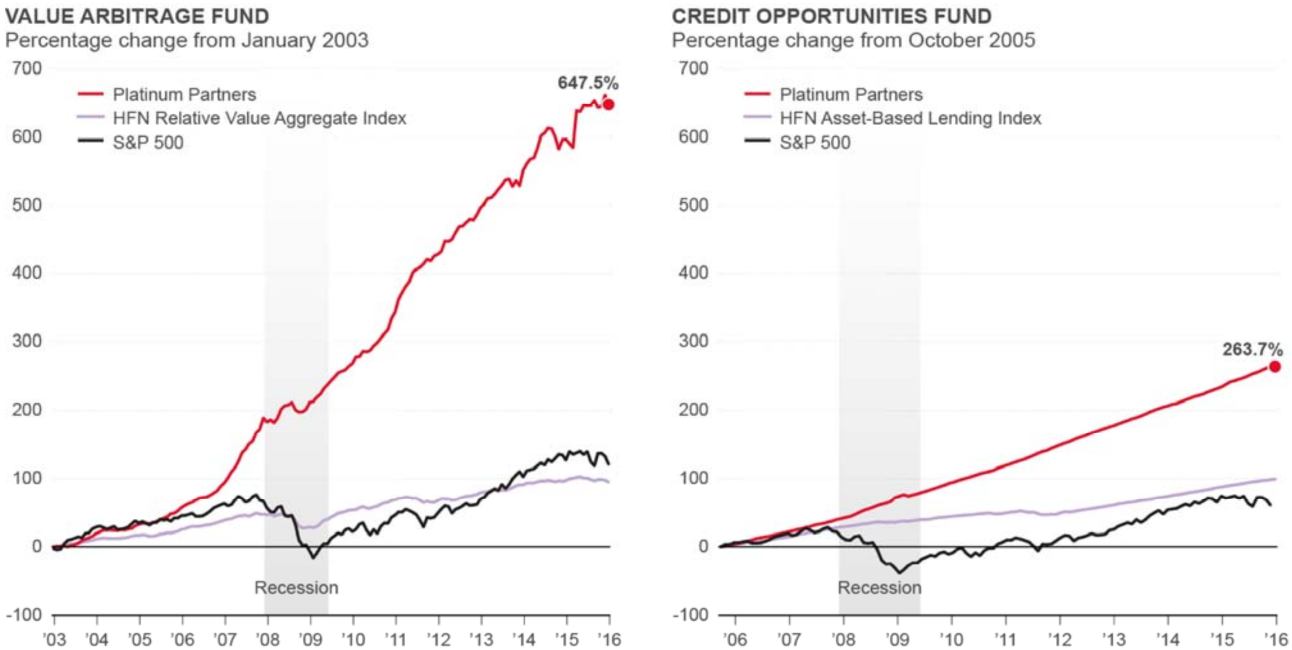
The person familiar with Platinum's thinking said the firm was aggressive with its investments, but always within the limits of the law.

One longtime Platinum investor, Bernard Fuchs, praised Nordlicht and said he was not concerned about liquidity issues or investments that might generate negative press.

“I know he’s an ethical, honest person,” said Fuchs, the former CEO of Lenoxx Electronics Corp who now invests personal and family money. “I would mortgage all our houses to invest with him, anything that he would go for.”

Platinum Partners' golden returns

Mark Nordlicht's New York-based firm has produced a steady stream of profits that few hedge funds can match, thanks to an aggressive style of investing centered on loans to businesses that others shun.



Sources: Platinum Partners; HFN; Thomson Reuters

One of the companies Platinum invested in that’s now in bankruptcy, Black Elk Energy Offshore Operations LLC, began to unravel after three workers died in an explosion on one of its rigs and oil prices collapsed. Documents reviewed by Reuters, including internal company emails and legal agreements, show how Platinum rescued its investment even before bondholders and contractors were paid.

Nordlicht has also maintained ties to associates with troubled pasts. Kevin Cassidy, who has served time in prison three times for fraud and tax evasion, is now a sales executive at Agera, the Platinum-owned power supplier. Murray Huberfeld, a financier

who was ordered to disgorge profits and fined for violating securities laws at his Broad Capital, provided Platinum with start-up money and ran Nordlicht's credit-focused hedge funds until Platinum took them over in 2011. He no longer works at Platinum but remains a client, according to 2014 tax filings for his charitable foundation.

Cassidy and Huberfeld did not respond to requests for comment.

The person familiar with Platinum's history said that the firm has made thousands of investments and that in the few cases that generated negative attention, Platinum was duped by deceptive business partners.

STRATEGIES AND SCHEMES

In an episode that attracted media attention in 2014, the U.S. Securities and Exchange Commission found that Platinum subsidiary BDL Group invested more than $56 million in a scheme operated by two brokers at other firms who exploited the terminally ill.

Patients in nursing homes and hospice care were gulled into providing personal information in order to receive a box of candy or a $250 gift; that information was used by the brokers to purchase long-term variable annuities that paid benefits to investors like BDL when the patient died soon after, according to the SEC.

BDL paid a combined $3.29 million profit disgorgement and penalty on the grounds that it made money on an illegal scheme. The two brokers at the heart of the operation were forced to repay their profits; one's case is on appeal with the SEC.

Nordlicht's friend and former colleague, Howard Feder, ran BDL and worked with the brokers to fund their strategy, according to the SEC. In a 2014 settlement with the agency, Feder was barred from the securities industry and paid a penalty of $130,000. At the time, the agency said Feder "understood the key components of the investment strategy."

The person familiar with Platinum's history said the firm was not aware that the brokers were engaged in illegal activity.

Feder did not respond to a request for comment.

With its 2010 investment in Glacial, Platinum got involved in a company that already had a record of questionable spending.

In 2007, internal financial statements of Glacial's New York unit, reviewed by Reuters, show that Glacial CEO Mole and his team spent more than $671,000 on travel and entertainment – the same year for which the company ultimately recorded a loss of approximately $5 million.

More significantly, the 2007 statements show $17.9 million in "consulting" fees paid to a mining company in the Democratic Republic of the Congo.

These dealings were the basis for some of the lawsuits alleging various forms of wrongdoing filed against Glacial and Mole in ensuing years. All of those lawsuits were ultimately defeated, dismissed or pushed off into bankruptcy proceedings.

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But one allegation gained additional weight in September last year, when Mole was arrested on charges of tax evasion. The New York attorney general alleged that he funneled Glacial profits into the Congo mining company, which operated in a region where illicit mining profits have been used to fund armed conflict. Reuters could not determine whether the Glacial-linked mining company was involved in conflict minerals.

Mole pleaded not guilty; he faces up to 15 years in prison if convicted. He did not respond to requests for comment.

The person familiar with Platinum said the firm was aware of Mole's spending and put protections in place to curtail it.

EARLY SCANDAL

Nordlicht grew up outside of New York City in suburban Long Island, and graduated from nearby Yeshiva University with a degree in philosophy in 1990. With $11,000 saved from what he had received for his bar mitzvah, he started trading commodity options. In these early years, National Futures Association records show, various New York exchanges fined him small amounts on eight different occasions, mostly for improper record-keeping.

In the early 2000s, after helping start a small private equity firm, he co-founded commodities brokerage firm Optionable. The New York Mercantile Exchange took a 19 percent stake in the fast-growing operation in early 2007.

Later that year, Optionable collapsed in a trading scandal. Nordlicht, who resigned as non-executive chairman soon after, was not directly implicated. His co-founder, Kevin Cassidy, was. He was sentenced to prison for the third time in his career, this time for 30 months for deliberately misstating the value of natural gas derivatives in conjunction with an employee of BMO Financial Group.

As Optionable imploded, Nordlicht was already building his Platinum business, having launched the Value Arbitrage fund in 2003 with about $30 million.

Shortly after his release, Cassidy was hired as managing director of business development at Agera, the successor company to Glacial, along with other former Optionable and Glacial employees. Agera did not respond to requests for comment.

The 47-year-old Nordlicht lives an unflashy life in suburban Westchester County with his wife and children, usually driving himself to and from work at Platinum’s sleek midtown Manhattan offices.

He has strong ties in the New York-area Jewish community, the source of some of his funds’ investors. These include, according to public tax filings for 2014, a charitable trust set up by day-trading pioneer Aaron Elbogen, who was fined $1.4 million for illegal trading and bookkeeping while the chief executive of Datek Securities Corp; the Century 21 Associates Foundation, led by department store executive Raymond Gindi; and the SFF Foundation, a non-profit controlled by the Schron family, known for its real estate investments. All declined to comment or did not respond to requests for comment.

Nordlicht has enriched his investors with his focus on higher-risk debt that can yield far more than traditional fixed-income investments. And after years of near-zero interest rates, it's a strategy increasingly sought out by big, otherwise conservative institutional investors hungry for higher yields.

Still, many big money investors who have looked at Platinum have walked away. Cambridge Associates, which counsels some of the world's largest pension funds and endowments, recommended to a client around 2010 that it not invest with Platinum and has not changed its stance on Nordlicht's firm since then, according to people familiar with the situation.

In an email, Cambridge said it does not "discuss specific investment managers." It added: "We can say that we take our due diligence process very seriously."

Among institutional investors that have considered putting money with Platinum but ultimately chose not to are the endowment of Yeshiva University, which is the alma mater of several Platinum employees, and large hedge fund allocator GAM, according to people familiar with the institutions.

One institutional investor that did get in is New York City's Correction Officers' Benevolent Association, according to two people familiar with the situation. The New York Times reported in June last year that Norman Seabrook, the union's leader, was under investigation by the U.S. Department of Justice for potentially using his position to enrich himself. A broad subpoena from prosecutors requested that the union supply information related to Platinum, but the connection was not clear, according to the report.

A spokesman for the union declined to comment. The Justice Department and Seabrook did not respond to requests for comment.

Nordlicht has tried to polish Platinum's image. In 2010, he hired ING Investment Management veteran Uri Landesman, who as president of the firm courts big investors and serves as its public face. Platinum declined to make Landesman available for an interview.

PUBLIC FACE: ING Investment Management veteran Uri Landesman was hired in 2010 as part

of an effort to burnish Platinum's image and woo institutional investors. REUTERS/Mark Hartman

Platinum also has added to its legal and compliance staff, increased information provided to clients, and created a "headline test" for prospective investments to avoid bad publicity, according to the person familiar with the firm.

CashCall, one of Platinum's investments, has faced legal actions from multiple states and the federal government for aggressive marketing practices and charging excessive interest rates.

That hasn't stopped Platinum from pursuing investments like CashCall, which lends to people at annualized interest rates that can be in the triple digits. The company has faced legal actions in recent years from multiple states and the federal government for its aggressive marketing practices and charging interest rates above state limits. It has been compelled to pay refunds to customers in some cases, according to regulators.

Platinum subsidiary Bayberry CF Management has set up six or more funds since 2009 that have lent at least $193 million to CashCall, according to marketing documents reviewed by Reuters. One CashCall fund expected to pay investors as much as 17.5 percent annually over three years, even after Bayberry took a 2 percent fee and 20 percent of the gains, according to a May 2013 marketing document.

A spokesman for CashCall declined to comment.

Nordlicht and his team often take positions in messy situations that can be difficult or costly to exit quickly. The perceived liquidity risk has been heightened by Platinum's policy of allowing investors to take money out of its two main funds every three months. That's far more frequently than most hedge funds that focus on private debt, which can lock up capital for several years.

“The mismatch in assets and liabilities could leave serious problems for those left holding the bag should the fund shrink in size,” said Seides, the veteran hedge fund allocator.

Platinum has told investors in recent years that it can manage mass redemptions thanks to large chunks of more liquid investments, at least in its main fund. It also believes that its loyal investor base of wealthy individuals and employees won’t flee at the first sign of trouble, according to another person with knowledge of the firm.

That logic didn’t hold up last year, as oil prices plummeted and volatility wracked markets. In response, Platinum extended the redemption notice from three to six months for the Value Arbitrage fund. Then, in December, it put about half the capital of the fund – much of it from the energy sector – in a so-called side pocket, meaning investors can’t take out their money on the normal schedule. When they can isn’t clear.

The move may ultimately protect investors from short-term losses, but changing liquidity terms is a last-resort measure that can turn investor sentiment against a fund.

BLACK ELK BLOW-UP

Platinum’s involvement with Black Elk shows just how complicated the firm’s investments can get – and how Nordlicht manages to wring profits from them.

Houston-based Black Elk was founded in 2007 to buy no-longer-productive offshore wells at discounted prices and then use new technology to squeeze more oil and natural gas from them.

Platinum began investing in Black Elk in 2009, first lending to it. Platinum later acquired preferred shares that eventually gave it majority control – and paid annual dividends of 20 percent or more, according to securities filings and an external valuation report reviewed by Reuters.

Then, in 2012, an explosion on a Black Elk rig off the Louisiana coast killed three workers, seriously injured three others and spilled oil into the Gulf of Mexico. A 2013 report from the U.S. Department of the Interior’s Bureau of Safety and Environmental

Enforcement found that the "safety culture" aboard the rig was "poor at best." Even before the explosion, the company received hundreds of bureau citations for safety violations.

The Department of Justice subsequently announced criminal charges against Black Elk and related contractors. Black Elk pleaded not guilty to involuntary manslaughter and other charges related to failing to follow proper safety practices. The case is pending.

That and other legal challenges after the explosion, combined with the collapse of energy prices, were among the issues that forced Black Elk into bankruptcy proceedings in August 2015.

AFTERMATH: A fatal explosion on a Black Elk oil platform in the Gulf of Mexico, pictured here soon after the blast, helped push the company into bankruptcy, but not before major asset sales that benefited Platinum Partners ahead of creditors. REUTERS/Sean Gardner

By then, however, the company had sold its main assets to Houston-based Renaissance Offshore LLC for $149 million. Most of the proceeds from that August 2014 sale went to a Platinum subsidiary. Black Elk then sold much of its remaining assets to Northstar Offshore Group LLC, a Houston company in which Platinum is a substantial investor.

Black Elk's creditors were left to wonder how Platinum was paid proceeds from the asset sale before them.

Together, the sales helped Platinum and its investors eke out a modest profit on their Black Elk bet, according to the person familiar with Platinum's history. The position was the largest holding in the Value Arbitrage fund on March 31, 2014, worth as much as $186 million, according to the valuation report.

Black Elk's creditors were left to wonder how Platinum was paid proceeds from the asset sale before them. Secured bondholders, for example, would normally have had first priority. Documents and interviews with people familiar with the transaction suggest an answer.

Just weeks before the sale to Renaissance closed, Black Elk asked holders of $150 million of its high-yield bonds to approve a measure that let Platinum receive proceeds of the transaction ahead of bondholders and other creditors.

Surprisingly, nearly 75 percent of bondholders consented, according to a Black Elk earnings announcement in August 2014. Reuters could not determine the identities of all bondholders or how they voted.

"No bondholder in their right mind would ever vote to have their covenants stripped like that," said one note owner. Lawyers and representatives for other secured bondholders did not respond to requests for comment or declined to comment.

Internal Black Elk emails and legal documents related to its bonds show that various Nordlicht-controlled hedge funds owned about 70 percent of the bonds before the vote and at least 47 percent after. The person familiar with Platinum's history confirmed that the firm voted its own bonds to approve the measure.

In addition, another large block of bonds was held by affiliates of reinsurer Beechwood Bermuda International Ltd, according to a Black Elk bond modification document from November 2014. Beechwood had hired former Platinum employee David Levy in November 2013 as chief investment officer of structured products. Levy returned to Platinum as co-CIO several months after the bondholder vote.

Beechwood spokesman David Goldin confirmed that Levy was responsible for Beechwood's purchase of Black Elk bonds and for voting them in Platinum's favor, along with the approval of other covenant changes. He said that those bonds were sold the month after Levy left.

Platinum believes that the measure would have been approved even if the firm's votes had not been counted by the bond trustee, Bank of New York Mellon, according to the person familiar with Platinum's position. The Renaissance sale proceeds, the person added, were used to pay back investors in a private equity fund Platinum created and from which it took no fees.

A lawyer for Black Elk declined to comment on Platinum, citing the bankruptcy proceedings.

Black Elk founder and CEO John Hoffman left the company shortly after the sale to Renaissance. Black Elk's next CEO, Jeff Shulse, left after the Northstar deal. According to a filing by Black Elk creditors as part of the bankruptcy proceedings, both men left in protest over cash from the sales being used to pay Platinum. The filing alleged "a series of questionable transactions" that allowed $96 million from the Renaissance sale to go to Nordlicht's firm "to the detriment of the company's creditors and estate."

Hoffman and Shulse declined to comment.

After the sale, some creditors cried foul. For example, in a lawsuit filed in Louisiana state district court in April 2015 against Black Elk, Nordlicht and Platinum entities, contractor Shamrock Management accused Platinum of engaging in an "unethical scheme" to suck assets out of Black Elk and pay itself while stiffing creditors. The lawsuit seeks nearly $1 million for unpaid work and damages.

That lawsuit and more than a dozen others like it remain unresolved in the bankruptcy process, part of 261 claims totaling $1.2 billion. The person familiar with Platinum's position called the lawsuits a frivolous attempt to bilk Platinum of cash.

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